

December 10, 2004

**to - The Honorable, Members
Council of The City
of Harrisburg**

and

The Citizens of Harrisburg

I herewith present the proposed Budget of the City of Harrisburg for the calendar fiscal year 2005.

At the outset, I can report that no property tax increase is proposed. In fact, with regard to real estate taxes, residential properties are slated for a reduction as a result of the gaming legislation adopted by Pennsylvania that allocates a portion of the proceeds to school property tax abatement. Harrisburg is eligible for the highest percentage of reduction that is authorized under state law. Since school real estate taxes are the majority of all property taxes paid, this will have a highly positive effect in this city. Increased property values, a lower cost of living and an increased inducement for private investment will be the result.

The school property tax reduction is a first step toward addressing the enormous inequities caused by two factors: the archaic and outdated property tax system in this state and the liberal tax-exemption system which, in Harrisburg's case, allows nearly 50% of all real estate in this city to be exempt from paying any taxes --- a circumstance that places a higher burden and higher tax rate on those who do pay taxes.

In acting upon the 2005 budget, some very significant fiscal realities must be considered.

Across our nation and state, county and municipal governments are facing the most difficult financial constraints since the end of World War II.

The National League of Cities, of which Council and this City are members, reported this month that over 3 out of every 5 cities in America are in recession and have been so for three years. Increased health benefits, insurance, pension, energy and salary costs are prime factors, as are the unfunded federal and state mandates that are forced upon local governments and their taxpayers to pay.

Employees and services are being cut in cities near and far. Deficits are commonplace. Earlier this year, Philadelphia disclosed a \$227 million deficit. Pittsburgh's difficulties are well known and in the past several days, the state Legislature acted upon special legislation to help resolve their issues. New taxes and major further cuts are coming in that city. In September, Allentown reported a \$1 million deficit. A projected budget gap in Lancaster forced the layoff of public safety staff. Dauphin, Perry and Cumberland Counties will be increasing property taxes, as will communities large and small in the region and elsewhere, such as Middletown, Newport, Lower Swatara Township and others. The tax increases range from 10% to 75%.

The issue is more pronounced in Pennsylvania because of the fragmentation of local government but across much of the nation, the issue of costs exceeding revenues remains the same. In Atlanta, Georgia, for instance, a 1% sales tax increase was passed, along with increases in water and sewer rates, to address the matter.

We shall now focus on items specific to Harrisburg, so that the context of this budget's preparation is understood.

There are many additional services, activities and projects we would all like to see in Harrisburg. The aggressive agenda we have always set for this city must, however, be balanced with the resources that are actually available.

Some of the factors that affect our costs are matters over which a local government has little control. Others are only marginally controllable. Let me cite a number of circumstances impacting the present year and next year:

(1) As has been well documented nationwide, the cost of health insurance has skyrocketed in America. Increases of 20% to 30% have been experienced by many in the public and private sectors. In 2004, Harrisburg's health insurance costs increased \$626,612 --- which is an increase of 10.9%.

(2) The recession in the national economy in the preceding two years resulted in a reduction of investment portfolio values across-the-board in all sectors. The Police Pension Fund was no exception. While investment values and earnings are now on the upswing, the reductions in these past two years require an infusion of additional monies. Under state law, Harrisburg is mandated to now contribute an additional \$1 million to the Police Pension Fund in 2005.

(3) Fuel and energy costs have reached their highest levels in U.S. history, as all consumers well know. Government is equally affected and Harrisburg has experienced higher expenses for both.

(4) PPL Electric Utilities, which supplies electrical energy to city facilities and streetlights, has filed a rate increase request with the Pennsylvania Public Utility Commission. While the company is not likely to receive the full tariff increases they are seeking, it is clear that some increase will occur in 2005.

(5) Salaries of city staff modestly increased in 2004 and some staff will receive modest increases in 2005.

(6) Two major events occurred this year that resulted in major costs and losses. The first was the August 4th storm, which included a tornado, that did more extensive damage citywide than any summer storm in at least three decades. The second event was the major flooding in mid-September caused by Tropical Depression Ivan. The full extent of city costs and losses from the flood are not fully known. Clean-up, recovery and replacement work will continue into 2005. Both events triggered overtime and other operating cost increases, the net effect of which is to reduce available cash that otherwise would have been available for a carryover Fund Balance to 2005.

(7) As a result of changes in state government's budget, the annual subsidy that was once received for the Advanced Wastewater Treatment Plant, which amounted to \$272,593 per year, was not received this year, the second consecutive year for this loss.

(8) The Law Bureau budget shows a noticeable increase, solely due to a pending lawsuit that has already cost \$245,710 in new costs and is expected to cost this much or more in 2005.

(9) As a result of the expanded tax-exemption law adopted five years ago by the Pennsylvania Legislature, the number of tax-exempt properties in the city has again registered a further annual increase --- despite the otherwise major gains being experienced as a result of economic development here.

(10) The extent of unfunded mandates from the Federal and state governments continues to extract a high price. Approximately 42% of the entire city budget is directly related to mandatory expenditures forced upon local government. In our case, this amounts to many millions of dollars and ties-up resources that would otherwise be available for meeting other local needs.

When there are tight budgetary circumstances, some will say that government should do as the private sector would do --- make cutbacks to trim the costs. The concept is generally sound but government is, by law, not permitted to do all the things that a private company or private citizen would undertake to create profitability.

For example, the City is mandated to provide police, fire and various types of public works services. With rare exception, we are prohibited from directly charging a fee for rendering these services. They are to be paid from general tax revenue.

Particularly with regard to public safety services, local government has no control over the level of demand. Citizens and businesses can create whatever demand they wish and the city is required to meet it. The matter is exacerbated by the fact that owners and occupants of tax-exempt properties, as well as non-residents, create demand for municipal services and pay nothing toward their costs.

Indeed, tax-exempt properties are significant generators and consumers of Harrisburg's municipal services and, as a city, we are required to pay for it.

A private business would eliminate a product or service that was not financially self-sustaining. In government, the law usually does not allow us to do so.

Equally problematic is that various laws, regulations and contracts do not permit the efficiencies and economies that are more easily employed in the private sector.

Nonetheless, the City has been ambitious in its further pursuit of reduced costs and balanced budgets. Some examples are worthy of note.

(a) Aggressive medical bill repricing in the Workers' Compensation Program has resulted in \$204,791 in savings in the first ten months of this year alone.

(b) Overtime throughout city government has been reduced by 22% in the past two years.

(c) To reduce operating expense and maximize sponsorship dollars, the City's two largest events --- the American Musicfest and the Kipona Festival --- have eliminated what had been the longstanding tradition of opening for a half-day before the full three days of each event.

(d) The City has created Harriscom, which has been approved by the Pennsylvania Public Utility Commission to be a wholesale buyer of telephone services. This produces a 31% savings in city government's local telephone expenses. We will now market the reduced cost service to others in the public and private sectors. We have been doing the same with the bulk-buying of natural gas supply for years, which is a program created and administered by the City and which has produced savings over the standard tariffs paid by other customers.

(e) During this year, the City has further reduced the number of cell phones, pagers and vehicles utilized in city operations.

(f) As a result of the effectiveness of the City's risk management and loss control program, the citywide insurance package this year was renewed at an increased premium cost of only 2.2% --- which is substantially less than insurance cost increases being experienced in the general market. This realized a savings of at least \$95,000.

(g) The Bureau of Traffic Engineering has been abolished and its staff and functions incorporated into the Bureau of Neighborhood Services this year. This allows for economies of scale in administration, a reduction in managerial staff, and the creation of a larger pool of public works staff to perform multiple functions with less separation of specialized duties. The Bureau of Neighborhood Services was formed last year, through the merger of the Bureau of City Services and Bureau of Sanitation, for the same reasons.

(h) The Mayor's Office of Special Projects is also being abolished and its small staff and functions amalgamated into the Mayor's Office of Economic Development.

(i) In the past fourteen months, downsizing and consolidation have eliminated three city agencies.

(j) Through changes in deployment schedules, some of which required a collective bargaining negotiation, reduced costs have been realized in various agencies; in the Department of Parks and Recreation, the savings this year will be \$43,000; in the Bureau of Neighborhood Services, it is another \$26,000; in the Bureau of Sewer, the savings will be \$18,000. Like amounts are expected to be saved by these agencies in 2005.

(k) For 2005, there will be no salary increases for any management and non-uniform personnel.

(l) The City has further reduced the number of city staff. This has been done through an Early Retirement Program, which saved \$686,110 this year, and by not filling most vacancies as they arose. For 2005, the entire city staff will total 663 personnel – the lowest number of city employees in as much as fifty years.

It needs to be made clear that most city agencies are under-staffed, with personnel complements less than what are needed to meet the continuous and ever-growing extent of what the City is asked to do by all the constituencies that make-up Harrisburg. The truth is that what is expected of city government far exceeds what we, as a community, are willing to pay.

(m) Another of the cost saving steps is arguably the most significant. Serious and extensive negotiation with the city's largest union --- the American Federation of State, County and Municipal Employees' Local 521, whose contract was due to expire this December 31st --- resulted in the following in a two-year contract:

(1) No salary increase in 2005; the next salary increase, at 2%, will occur on October 1, 2006;

(2) The employees have changed to a less expensive health benefits program, which also involves increased co-pays and deductibles;

(3) Life insurance coverage for existing employees and future retirees has been reduced;

(4) Certain staff schedules have been changed to reduce prospective overtime costs;

(5) The savings to the City of Harrisburg is \$1,537,830, the majority of which will be realized in 2005. The contract provides a no lay-off provision for remaining AFSCME bargaining unit members.

This contract was approved by a wide margin of the employees themselves.

These employees, knowing of difficult budgetary constraints, acted not only for themselves but benefited the City in a major way. Their agreement should not go unnoticed.

(n) As a result of the reduced number of city staff and because of the non-uniformed employees changing to a new, less expensive health insurance program, the expected increase in health insurance costs for all of city government in 2005 is only 1.3%, which is substantially less than what nearly all other employers are experiencing today. The 1.3% equates to a cost increase of \$94,403.

With regard to the budget, there are two accompanying actions that should simultaneously occur.

The Pennsylvania Legislature, in the early morning hours of this past Sunday, November 21st, amended state law to permit an increase in the Occupational Privilege Tax. The current rate of \$10 per year was established in 1965 and has never been changed. The costs of government have clearly increased in the forty years since.

This is the tax assessed on those who work in the City of Harrisburg, the overwhelming majority of whom are not residents of the city. All municipalities in the state, except Philadelphia, are now authorized to increase the annual rate to \$52. This amounts to \$1.00 per week and it is long overdue to do so.

Harrisburg, as the largest employment center in this region, is required to provide police, fire and public works services, along with streets, street maintenance, traffic signals, and a range of other infrastructure to accommodate business day visitors, the majority of whom work at tax-exempt facilities. All that has been a longstanding added expense to Harrisburg, as it is to any municipality that hosts major employment sites.

The new state law authorizing the increase changes the name of the tax to the Emergency and Municipal Services Tax and its expenditure can only be used for police, fire and emergency services, as well as road construction and maintenance.

We propose that the revised tax rate now be established and that the tax not apply to anyone working in the city making under \$10,000. This is the same exemption we have had in place for the Occupational Privilege Tax and serves to make sure that part-time, seasonal and occasional workers do not have to pay.

The second necessary action pertains to the Advanced Wastewater Facility and Sewage Conveyance System, which serves seven municipalities. Together, the residents and businesses of all seven communities pay for the plant and the large underground lines which carry sewage and stormwater.

You may have noted in various recent news reports in this region that a number of other sewage treatment plants are nearing capacity, which has resulted in a prohibition on any further connections to their sewer systems. What this means is that any economic development involving new homes or businesses or expansion of any existing businesses are denied.

We do not have this problem. The Harrisburg Advanced Wastewater Treatment Plant has been able to fully accommodate growth and development. Its operations have garnered top national, state and regional awards for performance, maintenance and safety.

City Council annually receives a copy of the independent audit of the Facility and its operations. For 2003, it reported an operating loss of \$976,087. For 2004, the projected operating deficit is expected to be \$615,656. The loss of the previous annual state subsidy of \$272,593 contributes to this circumstance.

The Sewer Revenue Bond Indenture, which is the governing document regarding the requirements for the Facility's annual financial performance, requires that the seven municipalities being served must provide sufficient revenues to prevent operating losses and, further, it strongly suggests the allocation of monies for depreciation of equipment. Presently, neither is occurring.

A rate increase of 12.5% is therefore necessary. The majority of this will be paid by non-residential customers in Harrisburg, including major tax-exempt employment centers, and by the other six municipalities. For the average Harrisburg residential household of 4 persons, it will mean \$1.89 per month --- essentially the price of a gallon of gasoline. For smaller households, it will be less.

Without the rate increase, it means that Harrisburg's General Fund taxdollars will be subsidizing the Facility and its Conveyance System that serve six other municipalities and the extensive number of tax-exempt properties. This is not an equitable circumstance and would take-away the taxdollars needed for police, fire and other essential services in Harrisburg itself.

Contained in the budget are the expenditures that flow from the policies and priorities that guide this government.

Included is funding for eleven additional officers to be hired in 2005. Public safety remains a high priority to both the City and its citizens. We have implemented the concept of Community Policing in the operations of law enforcement. For it to be effective, there must be a sufficient number of officers in the field to not only respond to calls for service

but to do proactive service that prevents crime and builds strong bonds of trust and cooperation between the officers and the community they serve.

Also included is funding for police vehicles and other city equipment, to replace the aging stock that has long exceeded its useful life.

Additionally, there is an allocation to establish a citywide Graffiti Removal Program --- which has long been needed.

There are other highlights which deserve mention.

For years, the City's budgets have been presented using a modified Performance-Based Budgeting approach. This will be expanded in 2005 with the City's fiscal staff converting additional City agencies into a pure performance-oriented accounting system, using performance measures, benchmarks and activity-based costing. This pilot program will thereafter be expanded to eventually include all City agencies.

The 2005 Budget maintains the two-tiered tax rate system that Harrisburg has had in place for years. We are unique in being the only municipality in Central Pennsylvania to offer this incentive for economic development. The present policy is to have a tax rate on buildings and improvements that is one-sixth the tax rate on land. It rewards private investment and saves money for the overwhelming majority of homeowners and businesses who would otherwise pay more through a single tax rate on property. Land is a finite quantity in this City because our boundaries cannot expand. We wish to discourage real estate speculation that ensnares land from productive use.

The Budget maintains the core functions of City government, albeit at less staffing. The full extent of City services and functions is not understood by all. It includes answering police and fire calls, codes enforcement, streetsweeping, sewer inlet maintenance, operating the regional crime information system, public safety communications center, streetlighting, traffic signals, year-round recreation programs, the largest municipal parks system in the Midstate, trash collection and disposal, housing and neighborhood renewal, business and industrial development, special events, tourism attractions, urban planning, providing the public water supply, processing and disposing of wastewater, and much more.

The Budget also sustains the expanded allocations in support of mass transit with not only the City's annual operating subsidy to Capitol Area Transit, which is the region's

bus service provider, but includes funds used to advance the Regional Rail Project, of which the City has been the primary proponent. The rail system is entering its final planning and engineering phase and will bring us to the point of being ready to proceed with construction in 2006. Our funding for mass transit comes from the special parking tax increase adopted a year ago.

While it does not cost the City any local dollars, the City's Fire Bureau continues to be the statewide administrator of Pennsylvania Task Force One, one of 27 federally-designated high-skill response teams for any disaster in the Nation. They were the first team dispatched to the World Trade Center on September 11, 2001. The Bureau also is the statewide administrator of a second in-state search and rescue team initially formed two years ago. Harrisburg is a national leader in assuring that the state and Nation are prepared for natural and manmade disasters.

Despite our tight budgetary circumstance, Harrisburg continues to make measurable progress. Last year was the best year in city history in the extent of new investment. The City issued 1,763 building permits representing \$351.5 million in new economic activity. It eclipsed the previous record, which had been set the preceding year.

This means that Harrisburg, in the current era, has issued a total of 30,429 building permits, for a total of \$3,451,000,000 in new investment. There are few cities in America of our size with a similar record.

When city government began its current economic development activities, there were 1,908 businesses on the City's taxrolls. Today, there are over 7,000, a new record.

As of the beginning of this year, the Part I crime rate in Harrisburg has dropped 56.5%, the lowest in over 35 years. The fire rate is down 76%, the lowest since records have been kept.

I am pleased to report that with the housing and neighborhood renewal work currently underway and with the work that will commence in the next eighteen months, Harrisburg will experience the most extensive wave of neighborhood-based revitalization at any time in its history. Over 1,400 residential units will be fully restored or newly built as part of this initiative.

The City continues with its in-house demolition program, which has proven to be far less expensive than private contractors doing the same work. Harrisburg apparently is the only municipality in the state doing its own demolition activity, which serves to remove seriously blighted and structurally unsound buildings from neighborhood areas.

While not a part of City government's budget, all of this economic development work, including neighborhood renewal, comes at a time when measurable progress is also being made to reform and improve urban public education in Harrisburg.

As you know, state law was changed nearly 4 years ago that substantially altered the governance of the Harrisburg School District. The District had sustained precipitous decline over an extended period, to the point that it became the most academically distressed district in Pennsylvania. This office is empowered to oversee the District and to appoint the five-member Board of Control.

There is much more to do but some gains have thus far occurred. The first major enrollment increases in over 30 years have occurred. The graduation rate has increased 63%. The number of graduates going on to higher education has increased by more than 300%. The dropout rate is down 58%. Test scores are showing measurable improvement for most students. The teenage pregnancy rate has dropped 61%. Harvard University has selected the Harrisburg School District as one of nine urban districts in the nation to serve as a prototype for urban educational reform in America.

Initiatives undertaken have included the establishment of the Alternate Education Academy, the creation of the Early Childhood Program for 3 and 4 year olds, and the After-School Program, which is an extension of the school day and at the end of which a hot meal is served.

There is a districtwide emphasis on literacy. The Math and Science Academy has been opened. Curriculum upgrades are being emplaced. Extensive professional development for administrators and teachers is a continuing activity.

Related to this work is the creation of the new Harrisburg University of Science and Technology. It is a non-traditional institution of higher learning focused particularly on workforce development needs, with emphasis on high technology skills. Its first classes open next September.

The University has two components. One is the new SciTech High, which is now in its second school year and which began occupying its splendid new quarters three months ago. It is a joint project of the University and school district. The Gates Foundation selected it as one of the top 12 high schools in the nation in the teaching of math and science. Of those 12 selected schools, Harrisburg's is the only public school. The rest are private or charter schools.

The Technology Business Incubator, to nurture the start-up of new businesses and to be a platform for faculty and students to apply their research and skills to new product and service creation, is also part of the University and opens next year.

In Harrisburg, Pennsylvania, we are literally creating a comprehensive education system from age three, at the Early Childhood Program level, to adult age post-graduate university level. No City in America is doing the same. The fact that such an extent of education reform and development is taking place here is not unrelated to the considerably expanded level of economic development activity now occurring, particularly with regard to neighborhood renewal. All of this creates significant new opportunity for city residents, especially inner city youth. I have long said that improving the schools and creating expanded college-level educational opportunities would be the best residential development program to occur, as it increases the level of homeownership, stimulates additional private residential investment, increases property values and reduces the rate of transience that existed in many previous years when families with children moved out of the City.

Harrisburg's progress can be measured in other ways, too.

Harrisburg, once written off and dismissed as a place tourists would want to visit, is now a major point of destination. Two years ago, the City issued 747 park permits to groups using park sites. Thus far this year, that number is 1,440, a 93% increase.

Attendance at City-sponsored special events two years ago was 1.3 million people. This year, it has thus far risen to over 1.9 million.

Next year, it is expected that the Harrisburg Fire Bureau will attain National Fire Service Accreditation, one of the few in the Nation to attain such high recognition. Meanwhile, the Harrisburg Police Bureau has continued to retain National Police Accreditation, the highest award in law enforcement in the United States and Canada. Of over 21,000 police agencies across the country, only 500 have attained National Accreditation. Harrisburg has also become one of the first to attain Pennsylvania State Law Enforcement Accreditation under a new program begun in this state last year.

Months ago, Harrisburg again --- for the 16th consecutive year --- achieved the Certificate of Achievement for Excellence in Financial Reporting and separately attained the Distinguished Budget Presentation Award for the 14th year. These are the top national awards in accounting, financial reporting and budgeting. Of 2,567 municipalities in this state, only three have achieved both.

Still further, the City --- for the 17th consecutive year --- has been designated a Tree City U.S.A., the Nation's highest community conservation award.

Harrisburg has come a long way from when, in the early 1980's, it was listed as the second most distressed city in the Nation and was on the verge of bankruptcy.

Then, as now, our challenges have been many. Our needs always exceed available resources. Priorities must therefore be set and the Budget document is a major means of expressing them.

Harrisburg, once the dying city of yesteryear, is attaining new levels of renewal and new life. Our progress has achieved national recognition. In our work, we are determining the viability of cities and urban public education in 21st Century America.

Harrisburg --- and the region for which the City is the hub community --- have yet to reach their full potential. Building on the progress thus far achieved, we embrace the future with vision, confidence and hope. With dedication to the highest ideals of public service, we reaffirm our commitment to Harrisburg achieving greatness in purpose, policy and deed. The 2005 budget is submitted in that spirit.

Stephen R. Reed

Mayor Stephen R. Reed